

10<sup>th</sup> February 2009

## **LEGAL UPDATE FAW 1/2009: REVENUE LAWS AMENDMENT ACT NO. 60 OF 2008 – IMPACT ON FUNDSATWORK**

The Revenue Laws Amendment Act No. 60 of 2008 was promulgated in Government Gazette No. 31781 on 8 January 2009 and came into effect on that same day. The following amendments are of relevance to FundsAtWork.

### **1. BENEFICIARY FUNDS**

#### **Financial Services Laws General Amendment Act No. 22 of 2008**

This Act provided that a death benefit may only be paid into a trust if the member, major beneficiary or caregiver nominated it. With effect from 1 November 2008 trustees of funds were not allowed to resolve that the benefit for a minor beneficiary be paid into a trust on their behalf. FundsAtWork will accordingly only give effect to a resolution by trustees to pay a benefit into a trust if that resolution was taken prior to 1 November 2008.

The Act also introduced beneficiary funds, which were defined as funds established exclusively to receive, administer, invest and pay death benefits. From 1 January 2009, payment may only be made to such a fund if it is registered under the Pension Funds Act.

The following applies in respect of beneficiary funds:

- Only approved death benefits may be paid into this fund.
- In the event of a beneficiary who is receiving a benefit from this fund dying before the total amount due to them has been paid to them, the balance of such benefit will be paid into their estate.
- The provisions of section 28 of the Pension Funds Act regarding the termination of a fund do not apply to beneficiary funds.
- The Registrar may prescribe matters that must be provided for in the rules of a beneficiary fund regarding voluntary termination and the transfer of remaining assets in that instance.

#### **Registration of beneficiary funds**

For a beneficiary fund to be able to operate with effect from 1 January 2009, that fund would have had to be registered as such on that date and its administrator had to be approved as an administrator in terms of section 13B of the Pension Funds Act. Towards the end of 2008 it became evident that neither of these two requirements would be met. The FSB then issued Information Circular 10 of 2008 on 11 December 2008, which provided for exemption from the provisions of section 13B until 31 March 2009, on certain conditions. This allows those administrators who met the conditions set by the FSB to temporarily administer those beneficiary funds until the section 13B approval is granted on or before 31 March 2009. In addition, the FSB

provisionally approved the rules of beneficiary funds, if those rules were submitted to them on or before 31 December 2008. It also posted a set of master rules for beneficiary funds on the FSB website, which meet the requirements of the FSB (and supposedly SARS).

### **Revenue Laws Amendment Act**

Previously, a death benefit was deemed to accrue to the member immediately prior to their death. It was then taxed in the hands of the deceased member. Where the benefit was paid into a trust for the benefit of a minor beneficiary, the benefit was taxed in the hands of the deceased member upon transfer and the growth thereafter was taxed in the hands of the minor beneficiary.

The Income Tax Act has been amended to include any amount awarded to a person by a beneficiary fund in the gross income of that person, except if the amount so awarded forms part of an amount transferred to the beneficiary fund for that person by a trust. This means that the benefits paid from a beneficiary fund will be taxed in the hands of the beneficiary, who is now the member of the beneficiary fund. Where however the death benefit has been paid into a trust and subsequently transferred to the beneficiary fund, that amount will not be taxed again, as it has already been taxed upon transfer into the trust. Any growth on the original amount derived from the trust will however be taxed in the hands of the beneficiary.

## **2. DEATH BENEFITS**

Paragraph 3 of the Second Schedule to the Income Tax Act has been amended to provide that the amount payable upon the death of a member shall be deemed to accrue to the beneficiary on the date of payment in terms of section 37C of the Pension Funds Act, subject to certain provisos, the following of which are relevant to FundsAtWork:

- Where the rules of the fund provide for the payment of a death benefit in a lump sum, but the beneficiaries choose not to take their benefits in a lump sum, but as annuities, no lump sum shall be deemed to accrue.
- Where the lump sum benefit is transferred to a beneficiary fund, no lump sum benefit shall be deemed to have accrued. This allows for tax-free transfers into beneficiary funds.

## **3. UNCLAIMED BENEFITS**

### **Financial Services Laws General Amendment Act No. 22 of 2008**

The Pension Funds Act was amended to include a definition for unclaimed benefits. Benefits effectively become unclaimed after 24 months from the exit event. The idea is to transfer these unclaimed benefits to unclaimed benefits funds, registered by the FSB and approved by SARS as preservation funds. Despite FundsAtWork having submitted rules for an unclaimed benefits pension fund and an unclaimed benefits provident fund on 2 October 2008, it still has not been registered.

### **Revenue Laws Amendment Act**

Paragraphs 1, 3, 4 and 6 of the Second Schedule to the Income Tax Act has been amended as follows with regards to unclaimed benefits:

- Paragraph 1: includes an amount transferred to an unclaimed benefits fund that was subject to GN35 tax in "E" of Formula B.
- Paragraph 3: where any lump sum benefit is paid to a pension preservation fund or a provident preservation fund as an unclaimed benefit, no lump sum shall be deemed to accrue. This provides for tax-free transfers into unclaimed benefits funds.
- Paragraph 4: a withdrawal benefit shall, subject to paragraph 3, be deemed to accrue on the earlier of –
  - the date on which the member elects to have the benefit paid to them;
  - the date on which the benefit is transferred to another fund; or
  - the date of their death.
- Paragraph 6: GN35 tax previously paid will qualify as a deduction.

The effect of these provisions is that although GN35 tax is payable on benefits that accrued to members where the exit event occurred prior to 1 March 2009, benefits accruing after 1 March 2009 will not be subject to GN35 tax. It is expected that GN35 will either be amended accordingly or withdrawn in total after 1 March 2009.

#### **4. PRESERVATION FUNDS**

##### **Taxation Laws Amendment Act No. 3 of 2008**

This Act, which came into effect on 22 July 2008, introduced definitions of pension preservation fund and provident preservation fund in the Income Tax Act and set out the requirements that have to be met in order to qualify as such funds.

##### **Revenue Laws Amendment Act**

The Income Tax Act has now been amended to provide that the rules of a pension or provident fund that does business as a preservation fund must be submitted to SARS for approval before 30 September 2009. If this is done, the fund will lose its status as a pension or provident fund, as the case may be, and will be deemed to have been approved as a pension preservation fund or a provident preservation fund, as the case may be, from the date of submission of the rules until the date that SARS notifies the funds of its status as a preservation fund. If a pension or provident fund which does business as a preservation fund fails to submit its rules to SARS before 30 September 2009, it will lose its tax approval status on 30 September 2009. The deeming provisions only apply to old generation preservation funds converting to new generation preservation funds. Totally new preservation funds will have to wait for SARS approval before commencing with their operation, like any other new fund.

Other issues relating to preservation funds that were clarified are the following:

- It allows for transfers of divorce order payments. In respect of a provident preservation fund, it allows transfers from a pension fund, pension preservation fund, provident fund, provident preservation fund or retirement annuity fund. A pension preservation fund does not make allowance for a transfer from a provident fund.
- It confirms that a member is only entitled to receive one payment from a pension preservation fund or any other pension preservation fund during their period of membership. However, the member may also transfer a portion of their benefit

- to another pension preservation fund, which will not be considered to be their one payment. This applies *mutatis mutandis* to provident preservation funds.
- The restriction to one withdrawal applies separately to each payment or transfer into the fund. Where the member has transferred more than one amount into the preservation fund, they will accordingly be entitled to this once-off withdrawal in respect of each amount so transferred.

## **5. PENSION TO PROVIDENT TRANSFERS**

The Second Schedule to the Income Tax Act is amended to provide that any amount transferred from a pension to a provident fund is deemed to accrue to the person concerned on the date of transfer. To avoid double taxation, that amount is included in "E" of Formula B, which will result in it qualifying as a deduction on retirement or death, and also in paragraph 6 as a deduction on withdrawal or resignation.

It should be noted that the Second Schedule has its own definitions of pension fund and provident fund, which are not the same as that of section 1 of the Income Tax Act. A pension fund as defined in paragraphs (a) or (b) of the definition of pension fund in section 1 does not have to comply with the list of requirements listed under paragraph (c) of that definition. It is therefore not restricted to only allowing one third of the retirement benefit to be paid as lump sum. A number of these pension funds' rules allow for the whole of the retirement benefit to be paid as a lump sum. The Second Schedule considers such a pension fund to be a provident fund. If a member therefore transfers from a pension fund as defined in paragraphs (a) or (b) of the definition of pension fund in section 1 whose rules allow for the whole retirement benefit to be paid as lump sum to a provident fund, it will not constitute a pension to provident transfer as envisaged by the Second Schedule. The reason for this is that this transaction is a transfer from a provident fund as defined in paragraph (b) of the definition of provident fund in the Second Schedule to a provident fund as defined in paragraph (a) of that same definition.

## **6. TAXATION OF WITHDRAWAL BENEFITS**

### **Current position**

The tax-free portion of a member's withdrawal benefit is calculated as follows:

- R1 800 deduction; plus
- The amount equal to the member's contributions that did not previously qualify for a tax deduction. In a provident fund this will be the member's total contribution, whilst in a pension fund it will be any contribution in excess of 7,5% of the member's pensionable remuneration.

The balance of the benefit is taxed on the member's average tax rate, which is based on the highest average annual tax rate for the tax year in which the benefit is payable or the previous year.

### **Revenue Laws Amendment Act**

From 1 March 2009, withdrawal benefits will be taxed in a much simpler way, based on a table similar to that applying in respect of retirement benefits, with the exception that only 7,5% of the R300 000 retirement exemption, that is to say

R22 500, will be applicable for pre-retirement withdrawals. The table has not been published yet, but is expected to look as follows:

<b>Lump sum benefit</b>	<b>Tax rate</b>
First R22 500	0% (tax free)
Difference between R22 501 and R600 000	18%
Difference between R600 001 and R900 000	27%
Amount over R900 000	36%

This table applies cumulatively over the lifetime of the member, which *inter alia* means that the tax-free amount only applies to the extent that it has not been depleted in respect of previous withdrawal benefits accruing after 1 March 2009.

Furthermore, the benefit no longer accrues on the day after the member resigns or otherwise withdraws from the fund but now accrues on the date on which the member elects to take the cash or transfer their benefit to another approved fund.

The existing tax concessions continue to apply. Members will therefore still be able to claim a deduction in respect of their contributions that did not previously qualify for a tax deduction. The member will furthermore also be entitled to a tax concession in respect of GN35 tax on an unclaimed benefit and the tax paid on a pension to provident transfer.

In addition, the amendments also now allow for the tax-free transfer of divorce order awards into a pension fund, pension preservation fund, provident fund, provident preservation fund or retirement annuity fund.

## **7. TAXATION OF RETIREMENT BENEFITS**

### **Taxation Laws Amendment Act No. 8 of 2007**

This Act introduced the simplification of the calculation of tax on retirement benefits. It provided for the taxation of lump sum retirement and death benefits accruing after 1 October 2007 in accordance with the following table:

<b>Lump sum benefit</b>	<b>Tax rate</b>
First R300 000	0% (tax free)
Second R300 000	18%
Third R300 000	27%
Amount over R900 000	36%

The Taxation Laws Amendment Act No. 3 of 2008 confirmed that this table applies cumulatively over the lifetime of a member as opposed to per benefit.

Following the changes to the taxation of withdrawal benefits as discussed in the previous paragraph, the tax-free amount of R300 000 will be reduced with effect from 1 March 2009 by the tax-free concession in respect of withdrawal benefits. It will also be reduced by all amounts included in gross income after 1 March 2009 in respect of divorce order awards payable by a retirement fund and pension to provident fund transfers.

## 8. MAINTENANCE ORDERS

Lump sum maintenance order deductions against the member's minimum individual reserve are taxed like a withdrawal benefit in terms of the Second Schedule.

Section 7(11) of the Income Tax Act was amended to allow for recurring maintenance order deductions by a fund from a member's minimum individual reserve. The Second Schedule has also been amended to provide for the exclusion of these recurring amounts from taxation under this Schedule. Instead, these amounts shall be deemed to be income accrued to the member on the date of the deduction and are to be taxed as 'remuneration'. It will therefore be taxed in the same way as monthly pension payments.

## 9. DIVORCE ORDERS

The oversight in the Financial Services General Laws Amendment Act that led to the deletion of the provision to deduct tax in respect of divorce and maintenance order deductions was corrected. Section 37D(1)(d) of the Pension Funds Act has been amended by restoring this provision with effect from the date on which the Financial Services General Laws Amendment Act came into effect, being 1 November 2008.

Paragraph 6 of the Second Schedule to the Income Tax Act was also amended to provide for the tax-free transfer of divorce order awards into a non-member spouse's pension fund, pension preservation fund, provident fund, provident preservation fund or retirement annuity fund. Please note however that a pension preservation fund is not entitled to receive a transfer from a provident fund (refer to paragraph 4 above).

With regards to the taxation of divorce orders, the following three scenarios were intended in the Explanatory Memorandum on the Bill:

<b>Date of divorce order</b>	<b>Date of accrual</b>	<b>Liable for payment of tax</b>	<b>Tax</b>
Before 13 September 2007	*Before 1 March 2009	Member	Average rate
	*After 1 March 2009	Member	Table for withdrawal
On or after 13 September 2007	**Before 1 March 2009	Member	Average rate
	**After 1 March 2009	Non-member spouse	Table for withdrawal

\* Accrual for income tax purposes takes place on the date that the non-member spouse makes an election as to whether the amount concerned should be paid to them directly or transferred on their behalf to another retirement fund, or on the date the amount is payable in terms of section 37D(4)(b)(iv) of the Pension Funds Act. Section 37D(4)(b)(iv) provides that in the event of no election by the non-member spouse, the fund must pay the amount directly to the non-member spouse within 30 days of the expiry of the 120 day period within which the non-member spouse should have made an election. Therefore the last day for accrual to take place is 150 days after the fund has requested the non-member spouse to make an election.

\*\* Accrual for income tax purposes takes place on the date that the deduction has to be made in terms of the Pension Funds Act. This is the date on which the non-member spouse makes an election, or, if no election is made within the 45 day period, the expiry of that 45 day period. A submission has been made to the FSB to the effect that the reference to the expiry of the 45 period is not correct and that it in fact should be the expiry of the 120 day period within which the non-member spouse must make an election. A response to this submission is still awaited.

Unfortunately, the inclusion of the new sub-paragraph 4(4) of the Second Schedule to the Income Tax Act is not in line with this intention in so far as a divorce order granted before 13 September 2007 is concerned. This sub-paragraph, which came into operation on 1 November 2008, being the date on which the Financial Services Laws General Amendment Act became effective, transfers the tax liability in respect of these divorce orders to the non-member spouse. Although it is the intention of the legislature to correct this in the Revenue Laws Amendment Bill that is expected to be published for comment towards the end of February 2009, the law as it currently stands has to be applied until then. This means that in respect of divorce orders granted before 13 September 2007, the one problem (the fact that tax could not be deducted from the member's minimum individual reserve from 1 November 2008 until 9 January 2009) has been substituted with another – tax may now be deducted, but the tax liability rests with the non-member spouse. It is suggested that administrators treat this as follows until the problem is solved:

- Where the non-member spouse has already been paid before the coming into effect of the Revenue Laws Amendment Act (9 January 2009) and a tax directive has been obtained - do not pay the tax over to SARS.
- Where the non-member spouse has not been paid yet – do not effect payment yet. Advise the non-member spouse of the problem and suggest that payment be delayed until the problem has been solved. If the non-member spouse insists on payment before the problem has been solved, apply for a tax directive in the name of the non-member spouse and deduct the tax payable from the non-member spouse's portion of the member's minimum individual reserve. If possible, do not pay it over to SARS yet. When the correcting legislation is promulgated, cancel the previous tax directive and apply for a tax directive in the name of the member. Deduct the tax from the member's minimum individual reserve for payment to SARS and pay the non-member spouse the balance of the amount awarded.

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